# CITY COUNCIL REPORT

MEETING DATE: 07/02/2003 ITEM NO. ______ GOAL: Short- and Long-term Economic Prosperity

**SUBJECT** **Los Arcos Redevelopment Agreement**

**REQUEST**

Adopt Resolution No. 6324 authorizing Contract No. 2003-115-COS, and approve Contract No. 2003-115-COS, a proposed Redevelopment Agreement between the City and Los Arcos Development, LLC for the redevelopment of the former Los Arcos Mall site at the southeast corner of Scottsdale Rd. and McDowell.

**Related Policies, References:**
- Council forms Los Arcos Redevelopment District -- 12/18/95
- Los Arcos Redevelopment Plan adopted -- 7/2/96
- Original Los Arcos Request for Proposals Issued -- 7/18/97
- Council Action on preferred Smith Group development option -- 2/5/02
- Council directs staff to proceed with negotiations with The Ellman Companies for the redevelopment of Los Arcos -- 2/18/03; reaffirmed by Council -- 3/3/03.

**BACKGROUND**

The former Los Arcos Mall opened in 1969, and was the focal point of commercial activity in the southern part of the community for several decades. In the early 1990's the mall began to decline, and the mall owner and the City looked at different options for revitalizing the mall and the immediate area. The Council formed the Los Arcos Redevelopment District in late 1995, and adopted a Redevelopment Plan for the area in 1996. In July 1997, the City issued a Request for Proposals on a 90-acre project site focused on the approximate 40 acre mall site (it also included Los Arcos Crossing, Papago Plaza, and other adjacent properties); The Ellman Companies, on behalf of Los Arcos Development, LLC (who had purchased the mall in late 1996) was the only respondent to this RFP, and was selected by the City to enter into an exclusive negotiation period with the City's Redevelopment Office and Redevelopment Board. This ultimately led to Ellman's proposal for the Coyote's Arena, but after a lengthy negotiation period, Ellman decided to build that facility in Glendale in March 2001. After this announcement, the City began a process of determining acceptable and feasible land uses for that site, which led to the hiring of the consultant team of Smith Group and Piper Jaffrey in May 2001. During the balance of 2001 and early 2002, the City and the consultants led an extensive community-based process, which led to a set of recommendations endorsed by Council. The focus of these recommendations was on the development of a community "town center" project, including neighborhood retail and services, some big box retail, a community event center,

Action Taken_______________________________________________ and potentially some higher density residential product. At that same point in time, The Ellman Companies also proposed a "power center" development for Los Arcos, anchored by Super WalMart, Sam's Club, and Lowe's Home Improvement; they proposed an upfront $42 million incentive package from the City to facilitate this project, later reduced to $15 million upfront with the balance paid over time. Neither of those options was acceptable to the City. Demolition of the old mall was completed in 2002, and the land remains vacant today.

Los Arcos Mall generated approximately $794,000 in total sales taxes to the City in 1995, its last full year with full occupancy. By 1998, the last full year before it lost its last anchor store, Los Arcos Mall generated $502,000 in total sales taxes. The entire area is also showing a long term decline in total sales tax revenues. In the 85257 zip code (south of Thomas), the total retail sales taxes (exclusive of automobile sales) dropped from $2,504,000 in 1998 to $2,133,000, a drop of 15%. Factoring in inflation (about a 10% increase over this 5 year period), this means that this area is realizing a net loss of approximately 5% per year in retail sales. In addition to the Mall, a number of other major retailers in the area have closed in the area, including Smitty's, Osco Drug, Best, and three auto dealers, along with several smaller businesses.

In early 2003, The Ellman Companies approached the City with a new proposal. The development plan was the same as had been proposed the previous year (a power center anchored by WalMart, Sam's, and Lowe's), but with a new proposed financial structure which eliminated any upfront contribution, thereby making the proposed transaction performance-based. On February 18, 2003, the City Council unanimously approved a motion to enter into negotiations with The Ellman Companies; this motion was reconsidered on March 3, 2003, and upheld on a 5-2 vote. The specific wording of the motion was as follows:

"Direct staff to negotiate a redevelopment agreement for Los Arcos with The Ellman Companies, and bring it back for Council consideration as quickly as possible, under the following general parameters:

- The development shall be a very high quality retail center, anchored by WalMart, Sam's, and Lowe's, and containing approximately 40,000 square feet of additional neighborhood retail services.
- It shall contain significant amenities, upgraded facades and landscaping, high quality materials, and other upgraded features.
- It shall be built within existing zoning guidelines meaning no variances for such things as height or setbacks, and special consideration shall be given to adjacent neighborhoods.
- City shall expedite all necessary approvals, and the developer shall open the entire facility including the public portions of the project as soon as possible, by a date to be set out in the development agreement.
- The City will financially participate in this transaction by sharing 49% of the total sales tax received from the site with the Developer for a period of up to 40 years (for the original uses and comparable replacement uses) up to a maximum of $31.75 million plus interest, and may qualify for an additional $10.0 million plus interest if project success exceeds projected sales levels. This sharing is on a performance basis only, and there are no guarantees from the City that the Developer will ever be able to recoup this amount. There is no upfront contribution from the City for this project, and the City will receive 100% of all other tax revenues (such as property tax at normal rates). The City's dedicated sales tax funds for preservation and transportation are fully protected.

- In exchange for its participation, the City will receive title to the land that the parking is located on and to the parking garage with the Developer or major tenants to operate and maintain. Tenants will have a parking easement.
- The City will own and can develop the approximate three acre parcel east of $74^{th}$ Street subject to an obligation to provide parking for Ellman's project."

Since that time, staff has negotiated a proposed Redevelopment Agreement (attachment A) with The Ellman Companies, keeping to the parameters outlined above. The Agreement includes a separate "Parking Lease" relating to the parking areas that the City will control, as well as a "Declaration of Restrictions" relating to the non-City owned portions of the site. A summary of the key terms and conditions in these documents follows below:

**Redevelopment Agreement Key Terms and Conditions**

1. The Development: The Ellman Companies (the "Developer") will construct a regional first-class retail "power center" anchored by a Super WalMart (minimum 183,000 sq.ft.), a Sam's Club (minimum 123,000 square feet), and a Lowe's Home Improvement Center (minimum 121,000 square feet). Additionally, there will be at least 25,000 square feet of small shop space, plus a restaurant of at least 5,000 square feet. The Developer will construct a two-level parking structure containing at least 2,100 parking spaces, and will also construct surface parking lots containing a minimum of 627 spaces, for a minimum total of 2,727 parking spaces. The project will include upgraded design, facades, landscaping, pedestrian amenities, public art, etc., all to be provided by the developer. The City's only participation will be in the construction of the streetscape improvements within the public rights-of-way adjacent to this site, but the City had planned to make those improvements anyway as a part of the McDowell Streetscape project.

2. Zoning/Regulatory Process: The project will be built within the existing zoning categories on the site. It will require Council approval of 6 conditional use permits – 1 each for the three "big box" anchors, 1 for the gas station, and 1 each for the auto lube/tire/repair components proposed for both WalMart and Sam's. The use permit process, along with the City's Development Review Board process and normal permitting process, will all be done in through separate processes apart from this consideration of the Redevelopment Agreement. The Developer has also requested the abandonment of $74^{th}$ St., with access between McDowell and the neighborhood to the south to remain through the center as a private street; this request would also be handled through a separate public process. Approval of this Agreement does not obligate the City to any other approvals, and the site plan shown in the Redevelopment Agreement is conceptual only.

3. Construction Timing: For the entire project (with the exception of the two small restaurant pads located along the west side of the project, which have up to 2 additional years) the following deadlines must be met. The anchor stores must acquire title to their parcels by 12/31/04, construction of the project must commence by 7/31/05, and the project must complete and open by 12/31/05. Failure to meet any of these deadlines will result in the cancellation of the Agreement. The only extension to these deadlines will be in the cases of referendums or specific legal actions against this Agreement; in that case, the deadlines will be extended by a period necessary to resolve such matters, but not more than 3 years.

4. City Ownership: After the completion of the improvements, but prior to any payments by the City, the Developer will deed to the City title to the parking; this will include approximately 20 acres of land, plus all improvements on those lands, including the parking structure and the surface parking lots. Based on recent City appraisals, the land would be worth about $11,750,000, while the parking improvements are valued by the Developer at $11,510,000 (including construction costs plus architecture and engineering costs), for a total value of approximately $23,260,000.

5. Parking Lease: All of the parking will be leased back to the project for an initial term of 40 years at a rate of $1 per month, with the option to lease the parking beyond 40 years. Years 41-50 may be leased at a rate of $400,000 per year; years 51-60 may be leased at a rate of $450,000 per year; years 61-75 may be leased at a rate of $500,000 per year; and years 76-99 may be leased at a rate to be determined at that time based on an appraisal of fair market value. The total value of the parking lease in years 41-75 would be $16.0 million. The project will also assume all costs associated with the parking, including maintenance, operation, repairs, utilities, insurance, and security for the term of the lease and for any option periods.

6. City Financial Participation: The City will share with The Ellman Companies sales tax proceeds generated by the project, up to a maximum of $36,750,000, plus interest at a rate of 7.18%, based on a sharing of 69% of the General Fund portion of the sales tax. The City's current sales tax rate is 1.4%, which is made up of the General Fund (unrestricted) portion of 1.0%, the dedicated transportation portion of 0.2%, and the dedicated preservation portion of 0.2%. Only the General Fund portion may be utilized for this investment; the dedicated funds for transportation and preservation will be fully retained by the City. The Developer's 69% of the General Fund portion of the sales tax equates to 49% (0.69/1.4) of the total sales tax collected at the site. The Developer receives no guarantees from the City as to the total amount of revenue the City will pay, as this is strictly performance based – only those sales tax revenues that are actually generated at the project will be available for sharing. The City's obligation to share in the sales tax revenues will cease when 40 years has elapsed (whether or not the Developer has recouped his investment), when the Developer has been paid $36.75 million plus interest, or when the Developer has failed to perform under the terms of the Agreement (such as if two or more of the anchor stores are closed for 4 years). The sales tax eligible for sharing shall include the construction sales tax, the lease sales tax, and retail sales tax charged on the sale of retail products. No other taxes generated by this site (such as property tax) are eligible for sharing; these will be paid at normal rates. The inclusion of an interest rate is based on the City's desire to pay this obligation over time based on the project's performance; if the City wanted to make a one-time lump sum payment of $36.75 million upfront, it could do that, and avoid paying any interest. However, doing so would put the City at risk for the performance of the center, rather than the Developer.

7. Timing of City Payments: The City will not be obligated to make any payments until the entire project is completed – defined as the opening of all three of the anchor stores, and the completion of the shops space (with the exception of the two pads, which do not have to be completed for 2 additional years). If there is a partial opening prior to the total completion, the sales tax

revenues paid by the open tenants will be held until the project is complete, and then will be paid with the first quarterly installment. If a tenant does open early, in no case may the payments for that tenant exceed 40 years. After completion, the City will make payments on a quarterly basis, based on actual tax revenues received by the City in the previous quarter.

8. Loss of Tenants: In the event that one of the anchor tenants closes, the Developer will not collect any tax from that parcel, as it would not be generating any tax revenues; additionally, if that space remains unoccupied for 4 years, no further tax revenues from that portion of the site will be paid even if a replacement tenant is secured later. In the event that two or more of the anchors close, and remain closed, for an overlapping period of 4 consecutive years, then the City will have the right to cancel the entire Agreement, in which case no further payments will be made by the City.

9. Replacement Tenants: If an anchor tenant closes, the Developer has the right to substitute an acceptable replacement tenant, in order to keep the Agreement in place as to that anchor tenant space, so long as that substitute tenant is open within the 4-year period noted above. The acceptable replacement tenants fall into two categories – by right, and by City approval. The "by right" replacement tenants will be deemed automatically acceptable if they meet specific criteria outlined in the Redevelopment Agreement (they must be national retailers, have a minimum number of stores, have a minimum average sales volume, have a minimum store size, have an investment grade credit rating, etc.). The "by approval" replacement tenants will be acceptable only if the City specifically approves them. The Developer anticipates having a first right to acquire back the sites from the anchors in the event of a closing.

10. Breach and Default: In the event of a default or breach under the terms of this Agreement, the City has the right to cancel the Agreement should the Developer fail to provide acceptable remedies during the default notice period.

11. Assignments: The Developer does have the right to assign all or a part of this Agreement. Certain assignments are by right, such as the sale of parcels to anchor tenants, while other assignments would require the approval of the City.

12. Land East of 74$^{th}$ Street: The City has the right to use the East Parking Lot (located on the east side of 74$^{th}$ Street, north of Culver) for development, so long as it replaces the surface parking on that site with an equal number of spaces. For example, if the City built underground parking with a like number of spaces, it could then utilize the surface and air rights for some other development.

13. Required Features: The following are examples of the key uses and activities that are required at this project:
    a. Accommodation for transit (i.e. bus bays, shelters)
    b. Upgraded features and amenities designed to create a first class shopping center – facades, landscaping, lighting, street furniture, pedestrian linkages, public plazas, pavement treatments, public art, etc.
    c. Free public parking
    d. The requirement to provide a non-exclusive parking easement for the Los Arcos United Methodist Church, in order to allow them to continue to have access to the parking lot directly west of the church.

14. Prohibited Uses: The following are examples of the key uses and activities that are expressly prohibited at this project:
    a. Sexually oriented businesses
    b. Gambling
    c. Bars/Nightclubs
    d. Massage parlors
    e. Sale of used merchandise (i.e. thrift stores, pawn shops, flea markets)
    f. Overnight recreational vehicle parking
    g. Day laborer solicitation
    h. Advertising signs (other than tenant signage)

15. Legal Costs: The Developer will bear all the costs related legal action involving the City and the Developer relating to this Agreement.

## Analysis & Assessment

**Significant issues to be addressed.** Numerous issues have been raised by the community regarding this proposed transaction. The City has received several hundred comments from citizens; these comments typically fall into the following general categories:

1. The Impact of Big Box Stores on the Neighborhoods: Concerns have been raised about the potential negative impacts of this development on nearby neighborhoods, such as traffic, noise, undesirable uses, etc. This proposed project will have less square footage than the former Los Arcos Mall. The Redevelopment Agreement does include provisions prohibiting undesirable uses (i.e. massage parlors, bars, used merchandise stores), and does specify the requirements to provide for the development of a first class retail facility. The Developer has pledged to work to mitigate any potential impacts. However, the specifics of the actual development plan will be determined through the City's use permit process for the "big box" stores.

2. The Impact of Big Box Stores on Existing Businesses: Concerns have been raised about the potential impact of the big box stores on existing businesses in the area. Research into the impact of big box stores has been inconclusive. There have been a number of studies that have documented the impact of WalMart and other big box stores on smaller, rural communities, but no definitive studies of the actual impact of these types of stores on urban areas have been found. Economic Vitality staff contacted a number of comparable communities in which WalMart had recently opened new stores; none of the communities indicated that they had experienced overall negative impacts, and most felt that the addition had resulted in a net positive for their communities. Based on this and other research, Economic Vitality would offer the following comments:
    a. Some of the existing businesses in the area will be negatively impacted by the proposed big box retailers; other businesses may be positively impacted by the additional customer traffic to this area. However, there is no way to definitively estimate what these impacts may be.
    b. If nothing happens at Los Arcos, businesses will also be negatively impacted and overall sales will continue to decline in this area.
    c. The addition of this center will result in a reduction in the leakage of retail sales by Scottsdale residents to businesses in adjacent communities, and will result in residents of adjacent communities

coming to Scottsdale to shop. Currently, due to the lack of these types of facilities in south Scottsdale, shoppers in south Scottsdale, north Tempe, east Phoenix, and the Salt River Indian Community, typically shop at centers outside of Scottsdale, such as the Pavilions and Arcadia Crossings.

3. Analysis by City Financial Advisors: Concern has been raised that the City's Financial Advisor, Piper Jaffrey, has not yet reviewed the final proposal to provide comments on the fiscal impact of this transaction. Piper Jaffrey is currently analyzing this proposal and will shortly provide an analysis to the City.

4. Financial Subsidies are a Poor Policy: There have been comments received that suggest the City should never use financial incentives for any economic development purposes. In general, the City has been very judicious with the use of financial incentives, averaging just one incentive per year, and all of them have been performance-based. When the City does use incentives, it is done when there is a compelling reason for using them, such as for the attraction of major tax generators, for the attraction of desirable employers, or for facilitation of major redevelopment projects. In the case of Los Arcos, if incentives are not provided, the owner of the property has indicated that the alternative is to leave the property in its current undeveloped condition. Additionally, the Los Arcos Redevelopment Plan, adopted in July 1996, contemplated the use of financial incentives for the redevelopment of Los Arcos.

5. Potential Alternative Uses: Concerns have been raised that City has not fully explored other alternatives that may be available for this site. Suggestions have been made that different retailers might be available, a different type of development might be feasible, or that other key users (such as ASU) are willing to go on this site. One of the primary issues is that the City does not own this site, and therefore must be willing to work with the owner on alternatives. The Ellman Company has not been willing to consider alternative plans or uses, believing that these options are not viable, and therefore even if alternative users were available, the City does not have the ability to look at these unless it was willing to directly acquire the site.

6. Alternative Options: Similarly, suggestions have been made that the City should consider its alternative options, including the potential for condemnation, or the potential to simply leave this solution up to the free market. These options are available to the City, but there is uncertainty as to how long these options would take before there would be development on the site, or how the City would pay for this option.

7. Timing of this Proposal: Concerns have been expressed that the City is rushing into proposal, and that it should wait until further information is received, such as a complete economic impact analysis, an analysis of other possible alternative uses, or the development of an overall master plan for the redevelopment of the entire southern portion of the City. While the City could do these things, they would extend the time that this site sits empty.

8. Analysis of the Pro-forma: The Developer's pro-forma has been questioned by a number of people, who believe that it is too optimistic, and therefore should not be used as the basis for this Agreement. The Developer has used sales per

square foot numbers that are higher than what these types of retailers typically generate in Scottsdale and the metro area, and uses growth rates that are also higher than what typical retailers generate over time. Economic Vitality staff analysis, using more conservative projections for both sales per square foot and growth rates, estimates that the net present value of this transaction would be $17 million over 20 years, or $25 million over 40 years. Since the proposed transaction is strictly performance based, if the pro-forma is optimistic, the Developer will receive less than the maximum amount, and in no case will the Developer ever receive more than 49% of the total revenues generated by this project.

9. Deal point terms: Comments have been made to the effect that the deal points are too expensive, the term is too long, etc. and that the Developer needs to modify those terms. Through the negotiation process, these terms were determined to be the minimum that would be acceptable to the Developer to proceed with this project.

10. Potential Legal Challenges: Concerns have been raised that this Agreement will be challenged on a variety of legal issues, most notably relating to the Gift Clause of the State Constitution. The City Attorney's Office has spent extensive time reviewing this Agreement, and feels that it is legally defensible.

**Community involvement.** Due to the extremely high profile of this project, this has had more public discussion and comment than any other development project in the City's history. Several groups, both pro and con, have been formed around this issue, and City Council and staff have received hundreds of comments.

## RESOURCE IMPACTS

**Available funding.** The City's financial obligation under this Agreement is tied to revenues directly produced by the site. City payments to The Ellman Companies will be made quarterly, based on a sharing of 69% of the General Fund portion of the total sales tax collections received by the City during each previous quarter. The City's obligations will immediately end at the occurrence of one of the following:

- 40 years has elapsed
- The Developer has been paid $36.75 million plus interest
- The Developer has failed to perform under the terms of the Agreement, such as if two or more of the anchor stores are closed for 4 years.

Only the City's Transaction Privilege Tax (sales tax) revenues are part of this Agreement; other City revenues, such as property tax, will continue to be paid to the City.

**Staffing, workload impact.** No significant staffing or workload impacts are anticipated as a result of this Agreement.

**Maintenance requirements.** The Developer will be solely responsible for all maintenance, operations, repair, utilities, insurance, and security. There are no City obligations for these activities.

**Future budget/financial implications.** Approval of this Agreement would obligate the City to share in sales tax revenues derived from this site per the terms of this Agreement. The City will not receive less than 51% of the total revenues off of this site. The City's Financial Services Dept. has noted the following observations:

- The proposed Redevelopment Agreement does not have any adverse cashflow or budgetary risk for the City. All payments will be percentage rebates of performance based revenue streams – from revenues that do not currently exist or that are currently being forecast for financial planning purposes. Future year financial plan revenue estimates will be adjusted based upon performance of the development, and rebate and interest expense payments will be budgeted per the terms of the Agreement.
- The City of Scottsdale will receive title to land and parking structures that will be booked as City assets, and will be subsequently leased back to the Developer.
- Although the payments under this Agreement will be performance-based, in order to comply with Generally Accepted Accounting Principles, the City will be required to record a long-term liability on its governmental activities balance sheet. The amount would be equal to the net present value of the estimated revenue of $36,750,000. The liability amount would be reduced as the performance based revenue and interest payments are made to the Developer – and will be relieved entirely after 40 years.

**Cost recovery options.** The City will receive – after completion of the improvements but prior to the start of any City payments – title to the parking structure, surface parking lots and other improvements, and the land the parking is located on. There are approximately 2,800 parking spaces proposed for the development, and the parking will cover about 20 acres of land (half the site). Based on recent appraisals commissioned by the City, the value of the land would be approximately $11,750,000, while the Developer's pro-forma indicates that the construction costs for the parking structure and surface parking will be $11,510,000, for an approximate total value of $23,260,000. Additionally, should the Developer exercise the option to lease the parking from the City beyond year 40, the income to the City in years 41-75 will be $16,000,000, followed by an adjustment in years 76-99 to an amount based on the fair market value of the parking at the time.

## OPTIONS

**Option A – Approve Agreement:** Approve the proposed Redevelopment Agreement as written.

**Option B – Approve with Modifications:** Approve the Redevelopment Agreement with any modifications the Council may desire. Amending the terms of the Agreement may, however, result in the Developer declining to sign it.

**Option C – Do Not Approve Agreement; Explore Other Options:** Do not approve the Agreement, and instead consider other options that may be available to the City. The City could issue a Request for Proposals (RFP) to determine potential interest from other developers and for other types of projects that might be feasible. For the RFP to be successful, the City would need to be able to provide for the ownership of the site, which would require either a direct purchase from the current owner, or the possible use of eminent domain (condemnation). The Developer has indicated a willingness to directly sell this property to the City for $60 million, despite the City's recent appraisal indicating a true market value of this site of $23 million. Alternatively, the City could look at condemnation as a means of acquiring the site at an amount closer to fair market value; the process to acquire by condemnation is estimated to take between 2-4 years, and has recently been made more difficult by the Arizona State Legislature. There are also no guarantees that the City would prevail on the right to acquire by condemnation, nor are there any assurances the ultimate valuation by the Courts would be at the same amount as the City's recent appraisal. Additionally, under a condemnation scenario, the City currently does not have the financial resources to fund the acquisition of this site.

**Option D – Do Not Approve Agreement; Wait for Free Market Solutions:** Do not approve the Agreement, and instead wait for the free market to provide for the ultimate redevelopment of this site.

**Proposed Next Steps:** If the City Council should approve the Redevelopment Agreement, the next steps would be the consideration of the required Use Permits and the abandonment of 74$^{th}$ Street, which would likely come forward for Council consideration within 4 months, followed by Development Review Board consideration approximately 2-4 months after that, and then Plans Approval/ Building Permits 1-2 months after that. The Developer has indicated that if all necessary approvals are received in time, they would like to open the project in late 2004 or early 2005.

**RESPONSIBLE DEPT(S)** Economic Vitality

**STAFF CONTACTS** David Roderique, Economic Vitality General Manager, 480-312-7601, droderique@scottsdaleaz.gov

**APPROVED BY**

David B. Roderique Date

Janet M. Dolan Date

**ATTACHMENTS**

A. Redevelopment Agreement No. 2003-115-COS
B. Resolution No. 6324